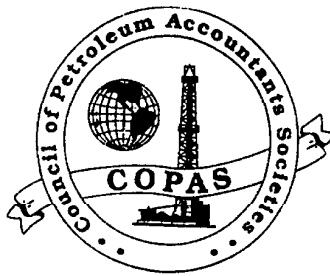


Acadiana
Anchorage
Canada
Colorado
Corpus Christi
Dallas
Fort Worth
Houston
Kansas
Los Angeles
Michigan
Mississippi



New Mexico
New Orleans
Ohio
Oklahoma City
Oklahoma-Tulsa
Permian Basin
Rocky Mountains
San Antonio
San Francisco
San Joaquin
West Central Texas
Wichita Falls

October 17, 1996



Mr. David S. Guzy
Chief, Rules and Procedures Staff
Minerals Management Service
Royalty Management Program
P O Box 25165 MS3101
Denver CO 80225-0165

RE: Comments on Proposed Regulations - Amendments to Transportation Allowance Regulations for Federal and Indian Leases to Specify Allowable Costs and Related Amendments to Gas Valuation Regulations

Dear Mr. Guzy:

The Council of Petroleum Accountant's Societies (COPAS) appreciates the opportunity to comment on the MMS proposed rulemaking governing allowable transportation costs and related amendments to the gas valuation regulations for federal and Indian leases. COPAS members have extensive experience with Royalty Management Program (RMP) rules and handle royalty valuation, determining applicable allowances, adjustments, bills, audits, and other royalty matters on a regular basis. Therefore, we believe our comments will be beneficial in improving RMP processes for both the MMS and industry. The proposed regulations referenced in the forthcoming comments appear in the July 31, 1996 Federal Register, pages 39931 - 39940.

General Comment

There is an underlying trend to this proposed rule as well as others issued recently. As the gas market evolves and lessees market more of the gas further from the lease, the lessor receives more royalty and the lessee bears more cost. We find this trend alarming. The implied duty to market ends at or near the lease. If the lessee markets downstream of the lease, MMS should bear their share of the cost paid by the lessee to enhance the value of the gas. However, MMS does not allow or is proposing to disallow many of these costs by calling them marketing costs. If MMS wants to share in the downstream values, MMS must share in the cost or establish valuation at or near the lease and not participate in the downstream market.

For decades, the gas industry has had its prices for interstate sales regulated at the wellhead. The methods used to establish a traditional regulated wellhead price considered both the cost of service to deliver the gas to the ultimate customer and to provide the lessee with an incentive to find and develop reserves.

FERC Order 636 is permitting the price to be established between a willing buyer and willing seller. The lessee, in an arm's length contract, has every incentive to sell gas at the highest price, given constraints unique to that lessee, and if shipping downstream, to get the gas moved for the least amount of cost. Lessees that fail to exercise their business in any other manner will ultimately fail to survive.

It appears that very little has changed between the 50's and the 90's in terms of computing a royalty price especially when it involves arm's length contracts. A value must be established. The price received for a gas sale should be reduced by traditional pipeline costs considered in setting regulated prices and previously accepted as wellhead valuation by the MMS. While there are some new services, such as hubs, these services are still traditional transportation services and should be allowed as a deduction when working back to wellhead.

Specific Comments

206.152(b)(1)(iv) How to value over-delivered volumes under a "cash-out" program

COPAS disagrees with MMS when it states that if it determines that the price specified is unreasonably low, the lessee must value all over-delivered volumes under paragraph (c)(2) or (c)(3) of this section. We assume MMS in this paragraph means a non-penalty reduced price. Based on that assumption, if the price paid is specified in a tariff approved by FERC, then that value should be acceptable to MMS and the MMS should not penalize the lessee.

206.152(i) Valuation Standards - Unprocessed Gas

COPAS believes that the language added regarding the requirement to market gas for the mutual benefit of the lessee and the lessor should be deleted. While MMS states in the preamble the purpose of this language is to place in the regulations their current policy, we see this language as a way for the Compliance Division to question every marketing decision made by a lessee. Gas is marketed everywhere from the wellhead to the city gate. Companies have to make decisions on how the gas will be marketed on a monthly basis, many times on an emergency or distress basis without allowing an ample amount of time for detailed analysis on the transaction. It would be a gross injustice to the lessee for MMS to come in after the fact and spend months analyzing a transaction to determine what the results might have been if we had made a different decision. The MMS might then allege that the lessee has not marketed to the mutual benefit of the lessee and lessor. While that may not be MMS' intent, we fear that will be the result of placing this language in the regulations. While companies of all sizes are deeply concerned with this, small companies who tend to market near the wellhead are extremely concerned.

206.153(i) Valuation Standards - Processed Gas

See comment above.

206.157(f)(1) Firm demand charges paid to pipelines.

COPAS believes the third sentence starting "The lessee also may not include the difference..." needs to be rewritten to clearly state that any gains or losses from the sale of unused firm charges are not royalty bearing. The way the sentence is currently written could be interpreted to say that the net difference is not included but the credit should be included.

The term "other reasons" in the fourth sentence is ambiguous and subject to vast interpretation. We believe a better term might be "other refunds".

MMS needs to further clarify the fourth sentence to state that any refunds received are not to be considered "gross proceeds" if no firm transaction was claimed on the Form MMS-2014.

206.157(f)(7) Payments for actual or theoretical losses

COPAS believes this paragraph needs to be clarified to state that gas supplied to the transporter for fuel, whether provided in kind or by cash reimbursement, is an allowable transportation deduction.

206.157(f)(8) Supplemental costs for compression, dehydration, and treatment of gas.

COPAS opposes the use of the word 'supplemental' and would recommend that it be replaced with the word 'other'.

We also believe that the purpose of this rule is to codify and provide guidance on the provisions of FERC Order 636. As that order is only applicable to pipelines under the jurisdiction of the FERC and it does not or should not apply to field transportation systems (commonly referred to as gathering systems), the language MMS is using under this paragraph is not appropriate. This is based on the fact that the vast majority of pipelines regulated by FERC are mainline transportation systems and because MMS relates marketable condition to pipeline specifications, all of these costs are deductible because the gas is already in marketable condition when it enters the pipeline. MMS needs to reword this paragraph to state that these costs are part of the transportation cost and are deductible.

206.157(g)(I)(ii) Banking/Parking Fees

COPAS disagrees with MMS position that these fees are storage fees and are, therefore, not deductible. Banking/Parking fees are not storage, they are transportation costs similar to wheeling. Even MMS stated that Banking/Parking fees are often only paper transactions. They should be considered a transportation cost.

206.157(g)(2) Aggregator/Marketer Fees

COPAS does not believe that the lessee is under any obligation to market away from the lease and when the lessee does market downstream of the lease that all costs should be deductible. As MMS is benefitting from any enhanced value due to aggregation we think MMS should also share in the cost, therefore, we disagree with MMS' position.

**206.157(g)(3)(i) Cash-Out Penalties
206.157(g)(3)(ii) Scheduling Penalties
206.157(g)(3)(iii) Imbalance Penalties**

MMS is disallowing these costs by stating that the lessee has breached its duty to market. While we disagree with the premise MMS used to disallow the cost, we believe that for the most part, these penalties can and will be avoided. COPAS believes that the lessee should have the ability to demonstrate to MMS on a case-by-case basis that the penalty was unavoidable. In situations where the penalty could not be avoided, the penalty should be deductible.

206.157(g)(4) Intra-Hub Title Transfer Fees

COPAS believes that title transfer fees, whether charged for intra-hub transfers or transfers at any pipeline interconnect, are fees to track the ownership of the gas through the pipeline and should be considered part of the transportation costs.

Subpart E Indian Gas

COPAS' comments are the same for the Indian gas and transportation as the federal gas and transportation. See corresponding paragraph under federal gas and transportation to obtain comment for Indian gas and transportation.

MMS requested specific comments on the following items:

1. MMS proposed that if a lessee receives a payment or credit from the pipeline for penalty refunds, rate case refunds, or other reasons, the lessee must reduce the firm demand charge used to calculate its transportation allowance reported on the Form MMS-2014. The lessee must modify the Form MMS-2014 by the amount of the refund or other credit for the affected reporting period.

COPAS agrees with MMS that this requirement is administratively burdensome and we would also state that we do not believe that it meets the meet MMS' objective to simplify and streamline royalty reporting. Also, as to federal leases, we believe this requirement is not cost effective to either industry or MMS in that it places a burden on industry and delays royalty payment to MMS. We recommend that for federal leases, the lessee be allowed to report the adjustment in the month received, allocated to leases.

For Indian leases, because of the major portion requirement contain in the lease terms, we do not believe a simplified reporting method is possible.

2. MMS proposes to disallow short term storage often known as banking or parking which frequently occurs at market centers or hubs because they considered these costs a marketing cost. However, MMS recognized that these costs are different from longer term storage and requested comment on whether and why MMS should allow these costs.

See COPAS' specific comments under 206.157(g)(1)(ii).

3. MMS proposes to make the changes to the valuation and transportation rules effective May 18, 1992, the effective date of FERC 636. MMS asked whether an earlier retroactive effective date is appropriate.

COPAS does not believe an earlier retroactive effective date is appropriate and we are also diametrically opposed to the effective date proposed by MMS. We can not, will not, and never have supported a retroactive effective date.

This particular proposal is troublesome for another reason. COPAS approached MMS prior to the implementation date of FERC Order 636 and explained the problems associated with this order and told MMS that industry needed guidance. Since that request, MMS has studied the order and held numerous internal training seminars on how these costs should be treated prior to providing any guidance to industry, which was the group that requested assistance in the first place.

We believe a retroactive effective date is highly inappropriate and recommend that the effective date correspond to publication of the final rule.

COPAS appreciates the opportunity to provide comments to this proposed rule. If you have any questions regarding our comments, please call me at 405-767-5044.

Sincerely,



John E. Clark
Chairman, COPAS Federal Affairs Subcommittee

It

cc:

Darrell Gingerich
Sandy Launchbaugh
Bill Stone
Mary Stonecipher
Salomon Tristan